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REGULATION, COMPETITION AND SMALL AND MEDIUM ENTERPRISES IN DEVELOPING COUNTRIES

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REGULATION, COMPETITION AND SMALL AND MEDIUM ENTERPRISES IN DEVELOPING COUNTRIES

I. INTRODUCTION

The main focus of this paper is to trace the channels or processes through which regulation and competition affect small and medium enterprises (SMEs) in developing countries. The principal issues to be addressed include the following: (i) to review the existing literature[1] on regulation, competition, and SMEs in developing countries and identify gaps in the literature; (ii) to trace the channels or processes through which regulation directly or indirectly affect Small and medium enterprises in developing countries; (iii) to identify the impact of competition or competition policies on SME development.

Utilities, Financial Intermediaries, Airlines, Pharmaceuticals, Nuclear energy, Transport etc are all subject to extensive regulation for both good and bad reasons. The principal rationale for regulation is to address market failures and to protect consumers from unfair competition and undue exploitation by natural monopolies and firms with extensive market power[2]. Thus, the basic objective of regulation (be it legal, financial, health and safety etc) is to achieve efficiency, stability and fairness (e.g. making firms pay for the social cost of production i.e. pollution) within an economy. Regulation should be designed such that it does not lead to further regulation but should lead to more efficient and effective policies (Viscussi, 1997).

During the 1980s and early 1990s, developing countries have undergone far-reaching market oriented economic reforms leading to considerable decline in the role of the state in economic activity. This has resulted in widespread privatisation, deregulation, and internal and external financial liberalisation. These policies have opened up their internal markets and exposed them to international competition[3]. However, the recent global trends and the wave of new mergers have lead to collusive pricing by large industrial corporations, which is sometimes difficult to prove let alone to punish (Singh, 1993). This therefore calls for a critical review of regulation, deregulation and competition policies in developing countries and to assess their impact on domestic production, particularly, the small and medium enterprise sub-sector.

In a rapidly growing economy, regulation provides a stable environment for firms; that is, it stimulates investment, does not create uncertainty, promotes R&D and innovation, provides efficient product and factor market and above all facilitate orderly exit and restructuring (OECD, 1997). Regulatory regimes that encourage competition and innovation are particularly necessary in promoting industrial competitiveness,/for job creation and economic growth.

However, whereas there is extensive array of literature on regulation and competition, very little has been done to directly assess the effects of regulation on firm competitiveness especially, small and medium-sized enterprises. The adverse impact of regulation is particularly harmful to SMEs because the cost of administration entailed in compliance has a disproportionate effect on SMEs. Besides, the flexibility of SMEs may be affected by regulation. Hence, the purpose of this paper is to identify and review the processes through which regulation affect small and medium enterprise development. It will specifically focus on the intermediary factors through which regulation directly or indirectly affect small and medium industries.

The paper is organised into four sections. Section one will be an introductory chapter highlighting the analytical background to the research. This will be followed by a review of the literature on regulation, competition and SMEs and identify gaps in our knowledge. The third section will then examine the effects of regulation on SMEs; this will involve identifying the various types of regulation and the processes through which they affect SME development. Section four will then trace the processes through which Competition affects firms, especially small and medium sized firms in developing countries.

II. LITERATURE REVIEW

This section reviews the literature on `regulation', `competition' and small and medium enterprises (SMEs) in developing countries. It will also identify gaps in the existing literature to enable us ascertain the directions for research.

Regulation

Regulation is said to have occurred when a government exerts control over the activity of individuals and firms (Roemer, 1993). It may also be defined as a government action to manipulate prices, quantities and the quality of products. Regulation provides the means by which government can manage the economy to achieve sustainable social and economic

outcomes. It also serves as a means of protecting and assisting small businesses. However, for regulation to have the greatest impact possible, it should be based on careful estimates of the cost of regulation to firms.

Competition

Competition is an unambiguously good thing in the first-best world of economists. That world assumes large numbers of participants in all markets, no public goods, no externalities, no information asymmetries, no natural monopolies, complete markets, fully rational economic agents, an efficient court system to encourage contracts, and a benevolent government providing lump sum transfers to achieve any desirable redistribution (Laffont, 1998:237). Laffont argues further that if any one of the assumptions necessary for the validity of the fundamental theorems of welfare economics cannot be met, restricted rather than unrestricted competition may be a better strategy.

On the basis of the above argument, "unfettered" competition may not be appropriate for developing countries that are characterised by incomplete and missing markets. In such economies, unfettered competition may lead to price wars and unhealthy rivalry, which may have repercussions on future investment, especially within the small and medium enterprise sector. In this regard, too much competition can be as harmful as too little. Hence, it is appropriate to ensure optimal degree of competition that would involve some degree of rivalry to reduce inefficiency in the use of resources at the micro level but not so much competition that would reduce the propensity to invest. At this point, one may ponder over the following issues: how does one determine the optimal degree of competition? Would this optimal level vary between countries?

Small and Medium Enterprises

There is no single, uniformly acceptable, definition of a small firm (Storey, 1994). Firms differ in their levels of capitalisation, sales and employment. Hence, definitions that employ measures of size (number of employees, turnover, profitability, net worth, etc.) when applied to one sector could lead to all firms being classified as small, while the same size definition when applied to a different sector could lead to a different result. The first attempt to overcome this definition problem was by the Bolton Committee (1971) when they

formulated an “economic” and a “statistical” definition (see Quartey & Kayanula, 1999 for a detailed discussion). Presented in table 1.1 is a summary of alternative definitions.

Table 1.1 Alternative Definitions

	Definition
World Bank since 1976	Firms with fixed assets (excluding land) less than US$ 250,000 in value is a small scale enterprise
Grindle et al (1989:9-10)	Small-scale enterprises are firms with less than or equal to 25 permanent members and with fixed assets (excluding land) worth up to US$ 50,000.
USAID in the 1990s	Firms with less than 50 employees and at least half the Output is sold (also refer to Mead, 1994).
UNIDO’s Definition for Developing Countries[4]:	**Large** - firms with 100+ workers **Medium** – firms with 20 - 99 workers **Small** - “ “ 5 - 19 workers **Micro** - “ “ < 5 workers
UNIDO’s Definition for Industrialised Countries:	**Large** - firms with 500+ workers **Medium** – firms with 100 – 499 workers **Small** - “ “ ≤ 99 workers

From the various definitions above, it can be said that there is no unique definition for a small and medium scale enterprise. In a study carried by the ILO, more than 50 definitions were identified in 75 different countries, with considerable ambiguity in the terminology used. The enormous variety of criteria applied includes size of workforce or capital, form of management or ownership, production techniques, volume of sales, client numbers, levels of energy consumption etc (Potobsky, 1992).

Nonetheless, the developmental role of the small and medium scale enterprises (SMEs) sector in developing countries has been highly recognised. They serve as engines through which the growth objectives of developing countries can be achieved. It is estimated that SMEs employ 22% of the adult population in developing countries (Daniels, 1994; Daniels & Ngwira, 1992; Daniels & Fisseha, 1992; Fisseha, 1992; Fisseha & McPherson, 1991; Gallagher & Robson, 1995). The sector which employs 15.5% of the labour force in Ghana (Parker et al, 1994), has experienced higher employment growth than micro and large-scale enterprises (5% in Ghana).

However, the precise nature of SMEs contribution to employment, growth and their productivity growth has been a bone of contention among researchers. As summed in Smallbone (1998), there is little doubt that, in aggregate terms SMEs have increased their share in employment and economic growth at a much faster rate than large firms, but the precise nature of their contribution has been a subject of much debate. This therefore raises the puzzle "do SMEs have a dynamic economic role?"

The arguments strongly favour the views that SMEs have great potentials to serve as engines of economic growth. However, SMEs face a number of constraints, which includes: financial, technical, raw materials, managerial, legal, regulation and competitive policies (see Sowa et al, 1992; Levy, 1993; Aryeetey, 1994; Kayanula and Quartey, 1999). Whereas considerable amount of literature has been generated on the constraints to SMEs especially in developing countries, very little is known about the interrelationship between regulation competition and small and medium-sized firms in developing countries. Regulation can stimulate productive and unproductive forms of competition especially within the SME sector and this may translate into positive or negative growth. It would therefore be appropriate to examine how regulation and competition affect SME development.

In assessing the impact of regulation on competition and SME development, it is important to take cognisance of the fact that the impact of regulation depends on the size of a firm. Small firms require protection against unlawful behaviour of others and it is important that governments, in formulating regulatory policies should take into consideration the different size categories of firms. SMEs face unique challenges and their development path is usually different from that of large-scale enterprises. Besides, they have fewer internal resources to draw on, their operational dynamics are more personalised and their decision-making practises are less formalised. Hence, the design of intervention programmes to promote the growth and development of the SME sector should be distinctly different from those policies targeting large-scale enterprises (White, 1999).

The argument that the impact of regulation on SMEs varies with firm size is emphasized in Levy (1993) where the impact of regulation on SMEs was compared between Tanzania and Sri Lanka. He also found that the impact varies across countries. The next section will

attempt to trace the processes through which regulation affects small and medium enterprises.

III. THE EFFECT OF REGULATION ON SMES IN DEVELOPING COUNTRIES

SMEs are necessary engines for achieving national development goals such as economic growth, poverty alleviation, democratization and economic participation, employment creation, strengthening the industrial base and local production structure. However, the ability of SMEs to realize these economic and social objectives depend on the regulatory and policy environment within which they operate (ILO, 2000). More often than not, regulatory policies often aimed at developing other sectors of the economy have unintended negative impact on SMEs. For instance, trade liberalization intended to boost export revenue often stifles local production due to the increased imports of cheap local substitutes. This argument is emphasized in the summary by the OECD (1997) below:

> " … While some regulations may deliberately favour SMEs (many regulations exclude the smallest firms), in general the adverse impact of regulation on SMEs can be particularly harmful. This is because SMEs are less equipped to deal with problems arising from regulations since they have less capacity than larger firms to navigate through the complexities or regulatory and bureaucratic networks. SMEs are more likely to be hampered by regulations because their strength stems from their flexibility. Some regulations designed to prevent entry into the market by dynamic SMEs are particularly detrimental" (p.13)

This therefore calls for a review of the various regulatory structures and how they affect SMEs.

However, in assessing the impact of regulation on SMEs, it is necessary to recognize that the impact will vary according to firm size. Whereas larger firms may appoint a member of staff to perform the administrative role and compliance associated with regulation, an SME may simply not have the resources to do so (White, 1999; Rajapatirana, 1999). Even when they have the resources, their size puts them at a disadvantaged position. In other words, meeting regulatory requirements raises transactions costs[5] of SMEs and puts them at a disadvantaged position as compared to large domestic enterprises and foreign firms that may not be operating under excessively restrictive regulatory regimes. In such regimes, transaction costs are high and for SMEs, they form a greater proportion of total costs than for large firms. The cost of registering a business, the need to use external accountants to satisfy regulatory

requirements, and time spent dealing with regulatory agencies are more expensive in terms of per unit costs of production for SMEs. Even where they are technically efficient, the actual costs that include transaction costs would make SMEs less competitive.

Secondly, although SMEs have special needs, in many instances developmental policies weigh in favour of large firms and sometimes foreign-owned firms, leaving SMEs in a distressed and vulnerable position. This therefore calls for a critical review of the various regulatory frameworks and how they affect the small and medium enterprise sector. Although in some cases, regulation/regulatory reforms have the added advantage of reducing the cost of doing business for the private sector as a whole but more particularly SMEs, regulation undoubtedly has adverse effects on firms particularly small firms. SMEs are disproportionately affected by regulation because the cost of regulatory compliance and inertia do not increase in proportion to firm size. Regulatory compliance involves time and money, which imposes significant costs on SMEs. Besides the costs of regulatory compliance and inertia, the direct costs of payments such as licensing fees, represents a significant cost of doing business. Holden, Sobokta and Locklin (1998) argued that payments made to avoid detection of non-compliance, or payoffs to government officials are the costs of operating in the informal sector.

Regulations on SMEs take different forms; it may be regulations governing business start-up, regulations governing business activity, regulation on labour practices, payroll changes, health and safety standards, taxation and foreign trade. These can be grouped under three major categories: economic, social and administrative regulation. This section will discuss the process through which the three major types of regulatory policies affect small and medium enterprises in developing countries.

(a) Economic or Structural Regulation

This is often used by governments to influence the allocation of resources with the view to improving the efficiency of markets in the delivery of goods and services. It includes:

(i) Restrictions on entry and exit to markets – registration requirements and procedures, permits and licensing laws, laws and regulations on choosing the business activity, form of the business, business location, choice of production process and machinery. These policies

often turn to be very restrictive and therefore hinder SME development. For instance, SMEs face high start-up cost often associated with registration and licensing requirements, the high cost of settling disputes or claims and excessive delays in court proceedings. Sometimes, the volume of administrative work involved in registration and licensing is just enormous as emphasized in the quote from the Bankok Post (14th June 1997) below:

> "… The government demands of the Go-go, not one nor two, but 28 licenses! The paper work involved (all applications are in triplicate) is mountainous. Even when correctly filled out and properly submitted with the requisite fees, getting the paper signed, stamped and approved adds a new dimension to the term `red-tape'. Some lucky people have their licenses granted in weeks, while others only get theirs after a few months – some do not get replies at all. Meanwhile, the establishment with a rent paid up opens and operates without proper documentation…."

Aryeetey et al (1994) also emphasized that the process of registering a company and obtaining a manufacturing license to commence business can be cumbersome in developing countries. However, their study on Ghana revealed that only 2 percent of sampled firms (all micro entrepreneurs) stated "too many regulations" as one of their first four constraints to expansion. Similarly, less than one percent of their sample (all small-scale) said government's regulatory bodies changed rules and regulations too often. The apparent low score on the regulatory constraints may be attributed to the lack of knowledge by SME entrepreneurs on the civil laws governing the legal aspects of their business. Even when the enterprise is registered, most have done so only to avoid complications from government officials, rather than to receive any benefit from being legal (Wasuntiwongse, 1999:18).

In addition to the excessive `red-tape', the absence of anti-trust legislation, which favours large firms and the lack of protection for property rights, inhibit SMEs access to foreign technology.

(ii) Monetary and Credit Policies: This includes inflation and money supply policy, interest rates policy, and requirements on collateral and security, banking and financial intermediation laws. Also, exchange rates and controls, mandatory allocation of credit resources to SMEs, policies on specialized credit schemes, the informal financial market, NGOs and other DFIs in credit and finance for SMEs all have both positive and negative effects on SME development. For instance, restrictions on interest rate affect the ability of

the domestic financial system to mobilize savings and channel them into productive ventures (Brownbridge and Harvey, 1998).

Requirements on collateral and security are lsorestrictive policies that hinder SME development. Since the SME sector have generally been considered as risky, financial institutions demand collateral from entrepreneurs often in the form of landed property prior to the granting of a loan or credit. Whereas this serves as a form of security to the institutions, it seriously hinders SME entrepreneurs from obtaining credit for start-up, for expansion or working capital purposes.

Another policy tool that is having effect on the SME sector is exchange rate and capital controls. Excessive exchange controls limit the scope of risk diversification and isolate the domestic financial system from developing in international markets. For instance, capital controls in Ghana and Nigeria prevented foreign banks and deposit insurance companies from entering domestic markets, and this stifled competition and inhibited innovation. Whereas many countries have relaxed controls on capital and exchange rate, there are quite a few who directly control their exchange rate markets and capital movements. These restrictive policies are often put in place to prevent capital flights and a repetition of the Asian crisis. Ironically, those developing countries with liberalized exchange rate regimes are experiencing rapid depreciation in their exchange and this is having repercussions on imports, especially raw materials needed by the domestic industrial sector. Harrigan and Oduro (2000:160) mention that exchange rate devaluation has made it hard for small entrepreneurs in Ghana to borrow enough local currency to purchase foreign exchange in the auction market and to purchase imported capital goods.

Many developing countries in an attempt to control inflation have applied restrictive credit policies, that is, ceilings on bank lending. The need to maintain a tight credit policy arose in view of the high growth in money supply and hence inflation remained high; broad money supply growth averaged 42.3 percent between 1984 and 1990 (Brownbridge, 1995). Credit ceilings have being a constraint to bank lending to firms[6]. In 1988, several banks in Ghana started extending credit in the form off balance sheet acceptances to evade the ceilings until prevented from doing so by Bank of Ghana Directive in March 1989 (Brownbridge, 1995). Consequently, commercial banks in Ghana reported to an IMF mission in 1989 that the

ceilings prevented them from accommodating effective demand for credit from credit worthy customers, as a consequence of which they continued to hold substantial levels of excess reserves (IMF, 1989:17-20 & 88-90). Sowa (1991:29) reports that in February 1989 six banks were barred by the Bank of Ghana from taking part in the weekly foreign exchange auctions for exceeding their credit ceilings.

In addition to the global ceilings on credit mandatory lending to certain priority sectors of certain developing countries exists. There is widespread regulation on credit allocation to priority sectors (especially agriculture and small and medium industries) at interest rates often below the market equilibrium rate. This policy has widespread implications on the financial system. It severely affect banks in performing the intermediation role since these mandatory lending are often done at interest rates far below market rates. This point was emphasized by Brownbridge and Kirkpatrick (1999) where they argued that economic regulations particularly those which attempt to direct banks to lend to sectors to which they would not be willing to lend on commercial grounds is likely to worsen banking sector fragility. Since such sectors are usually not regarded as credit worthy or the transactions costs of lending to such a sector is too high, government directives to force credit to such a sector will severely constrain banks ability to perform their intermediation role. Aryeetey (1995) reports that sectoral credit directives in Ghana and Nigeria failed to achieve the intended objectives; the sectoral credit ceilings were ineffective as large discrepancies were recorded between actual lending to particular sectors and permitted levels[7].

(iii) Trade Regulation: The import and export procedures in developing countries often increases the transactions costs of SMEs. The volume of paper work, delays, bribes often absorb the resources of SMEs, particularly, those dependent on international trade either for imported raw materials, capital goods, or those that export their products. In most cases, smaller firms export indirectly by subcontracting to large exporters. In such cases, the costs of regulation are reduced. However, regulation constrains medium exporters and small firms that wish to grow through exports. Holden et al (1998) adds that although regional integration and the harmonization of trade have reduced trade barriers, custom and port procedures are often cumbersome by international standards. Since SMEs export or import

in smaller quantities, the fixed costs of dealing with import and export procedures heavily weigh against SMEs.

(b) Social Regulation

This refers to regulations on social conduct and is often used by governments to control the behaviour of firms in order to protect social rights and values. It includes:

(i) Health and Safety

Health and safety are two important areas where regulation cannot be removed because the consequence of ineffective or un-enforced regulation in these two areas will be too detrimental. Besides, the cost of this type of regulation is not so clear since some studies have shown that increases in work place safety is associated with increases in worker productivity (Egorov, 1997).

Three forces govern work place health and safety standards: market forces, direct regulation, and incentives that workers' compensation create to increase overall safety. In each case, it will be in the interest of firms to invest in methods and devices that make the workplace safer and protect consumers against defective products. Improved safety standards serve as an incentive to reduce wage premiums for risks, reduces penalty for non-compliance and reduces payments made to workers or consumers affected by inadequate safety precautions as well as increases benefits from higher productivity.

(ii) Environmental Protection

SMEs are necessary engines of growth and employment. However, they are also substantial contributors to environmental pollution and this calls for government action to regulate their operations especially waste disposal and the use of up-to-date machinery to minimize pollution. SMEs have less financial resources to enable them tackle new pressures such as environmental regulation. Smaller firms, particularly in developing countries use old technologies, lack the awareness on legislation and their own environmental impact. Ironically, there is very little hard data available to determine the sector's contribution to pollution. Collectively, their large numbers means that environmental impact is substantial. Hillary (2000) mentions that their combined impact is unknown in pollution terms but their environmental impact at the local level can be determined.

(iii) Controls over labour contracts and employer employee relationships

This usually comprises wage policies, labour legislation, skills training system and many others. Inflexible labour codes and other indirect labour cost weigh heavily against SMEs, raising their cost of doing business and affecting their flexibility to adopt. In most cases, governments usually set the legal framework for settling disputes, work stoppages, strikes, and the establishment of unions. It also sets out the minimum conditions of employment, usually dealing with hours of work, holiday pay, and severance and compensation benefits. Even in some cases, governments define the scope of employment for women (ILO, 2000).

Labour regulations which affect small and medium sized firms can be divided into three categories: minimum wage legislation, mandatory non-wage benefits, and job security guarantees. The processes through which the three types of labour regulation affect SMEs is examined below:

(a) Minimum wages

High minimum wages deter SMEs from hiring the number of workers needed for expansion and if there is substantial unemployment in the country, it introduces inefficiency. Minimum wages indirectly increase transactions costs for SMEs, particularly, where it encourages informality or temporary hiring. Minimum wages can be a subject of disputes between business owners, workers and government departments dealing with labour issues thereby increasing transactions cost to SMEs. However, Holden et al (1998) argued that minimum wages is not a binding constraint on SME employers in Latin America. In most cases, the wage is well below what unskilled labourers earn and it is rather the non-wage labour costs associated with hiring additional workers that is "prohibitively expensive".

(b) Non-wage compensation: This includes housing bonuses, transportation allowance, family wage allowances, extended paid maternity leave, employers insurance contributions, end-of-year bonuses, sick pay or leave and other forms compensation. Holden et al (1998) argues that the direct costs of these payments are not transactions costs, but rather additional labour costs. Besides the financial burden, these additional labour costs represent an additional accounting and administrative burden for conducting formal business. This extra burden therefore serves as an incentive for SMEs to remain informal. If they do formalize,

larger SMEs will rely on temporary labour or sub-contract. The cost of searching and hiring temporary labour can also be enormous and besides by relying on temporary labour, SMEs are not encouraged to invest in training such workers, thereby affecting labour productivity.

(c) Job Security

This includes severance pay requirements, laws governing the hiring and firing of workers, etc. Severance pay is a direct cost and place an extra burden on firms adjusting during economic downturns and serves as a disincentive to hiring workers. They encourage temporary hires and make SMEs bear the necessary costs associated with these choices. This viewpoint was also emphasized in Holden et al (1998) when they stated that

> `… in Latin America, workers dismissed without cause are entitled to full severance payments. Just cause is usually limited to such criteria as absenteeism, theft, sabotage and insubordination. Poor performance is seldom included, and even where it is, it can be especially difficult to prove in court. Such strict criteria for dismissal often have the effect of fostering labour disputes, which increases transactions costs to businesses. They, like severance pay, constrain businesses from hiring workers permanently and formally in order to adjust to adverse economic conditions (p.10)

Hence, by increasing the costs of exit, job security guarantees raise the cost of doing business for SMEs. However, some writers have argued that there is very little connectivity between government regulations on labour and SME development. In Thailand for instance, White (1999) asserted that since SMEs hardly comply with the above legal requirements, it is very difficult to see the connectivity between these legislative framework and their impact on SMEs.

(c) Administrative Regulation

Administrative Regulation is often instituted to control how governments collect, manage and appropriate revenue and property. The principal objective of such controls is to promote administrative efficiency of the public and private sectors. It includes taxation patent protection for interventions, designs and products, copyright protection, trademarks protection and bankruptcy acts.

Taxation: Taxation is a major field of government activity that has significant impact on SMEs. Tax policies include investment and tax incentives, taxes applying to starting and

operating a business, capital-based and income-based taxes. Taxation can be used to stimulate one area of economic activity (through tax incentives) or limit another area (import duties to limit foreign competition). The cost of complying with tax regulations often makes them a principal regulatory problem to SMEs in developing countries. There are three ways in which taxation affects the transactions costs of SMEs and they are:

(a) Complexity: complex tax systems require more business resources for calculating and complying with tax legislation. Tax complexities involve four factors: the number of taxes, timing of tax reporting and payment, the tax base and exemptions. A complex tax system is characterized by large numbers of direct income and payroll taxes. Holden et al (1998) mention that in Brazil, companies face over 50 different taxes and levies. Thus, complex tax systems force SMEs into hiring expensive external accountants to prepare their tax returns.
(b) Enforcement: The transactions costs imposed on SMEs by a country's tax complexity will be unavoidable where enforcement is strong. On the other hand, in cases where enforcement is weak these costs can be avoided. However, tax avoidance introduces additional cost by promoting bribery, corruption and informality.
(c) Stability: In countries where the rules of taxation are continually changing, SMEs incur transactions costs in leaving and complying with new systems. On the other hand, if the rules are fixed but their application is discretionary, it can increase transactions costs by placing extra costs on long term planning, making both coordination and information gathering more costly.

IV. EFFECTS OF COMPETITION ON SMES IN DEVELOPING COUNTRIES

It is evident from the various discussions above that regulation increases the transactions costs of SMEs which in turn makes them less competitive, deters entry and or the formation of new businesses, reduces profit and hence employment, income and economic growth. The apparent rise in competition in developing countries has been prevalent after the economic reforms in the 1980s.

Prior to the IMF and the World Bank sponsored Economic Reforms in developing countries, a majority of SMEs were sheltered from competition. However, the reform precipitated attempts to reduce and to encourage efficient markets in developing countries through various policy

reforms. This includes the withdrawal of subsidies and the removal of protection from local industries, in addition to the trade and exchange rate liberalisation policies. These policies have jointly or partly led to the closure of many inefficient firms, which could not face competition from local producers as well as imports. Ironically, very few studies have been done in developing countries to assess the impact of competition on SMEs and even where they have been investigated, the methodology is woefully inadequate; entrepreneurs are asked if they face competition and their responses are used to draw general conclusions.

One major source of competition includes local firms (micro small, medium or large-scale firms). Competition from an equal-sized firm is a healthy phenomenon and may lead to increased efficiency in production. However, competition from a bigger sized firm may pose a serious threat to small-scale enterprises and may lead to output declines. Sowa et al (1992) reported that two-thirds of sampled small-scale firms in Ghana face competition from local producers. Competition in China takes a different form; large firms particularly SOEs initiate new products, which are then taken over and produced at lower cost by Town and Village Enterprises (TVEs). The intensification of competition between these two firm sizes has caused their profit rate to converge and in some cases to fall (Thoburn, 1997).

Another important source of competition is from imports arising from trade liberalisation. Trade liberalisation has encouraged the importation of cheaper locally manufactured substitutes into developing countries. Although this may lead to healthy competition, it may also stifle the SME sector and hence poses a serious threat to the sector.

V. CONCLUSION

The principal focus of this paper is to review the existing literature on regulation, competition and small and medium-sized firms and to trace the intermediary factors through which regulation and competition affect SMEs in developing countries. A review of the existing literature indicates that very little is known about the interrelationship between regulation, competition and small and medium industries in developing countries. Regulation may stimulate productive and unproductive forms of competition, especially within the SME sector and this may translate into positive or negative growth depending on the direction of change.

It is evident from the various discussions that economic, social and administrative regulation increases the transactions costs of SMEs which in turn makes them less competitive, deters entry and or the formation of new businesses, reduces profit and hence employment, income and economic growth. The papers cautions that in assessing the impact of regulation cognisance should be taken of the fact that the impact of regulation varies according to firm size. Smaller firms incur more transaction costs in complying to regulations and dealing with inertia.

Research Gaps and Further Directions for Research

The discussions so far have revealed that there are quite a number of gaps in our knowledge on regulation, competition and small and medium-sized firms. First, there is very little empirical analysis on the impact of regulation and competition policies on small and medium enterprises in developing countries. Even where such a study exists, the methodology is woefully inadequate; entrepreneurs are presented with a set of constraints (including regulatory constraints) and asked to choose those that affect their businesses. This methodology should be complemented with an empirical analysis, that is, empirically compare the various regulatory regimes and firm performance (growth in sales, profit, employment, etc)

Secondly, very little is known about how the regulatory environment affects the behaviour of small and medium enterprises. Does regulation encourage compliance or promote illegal activities? Does regulation discourage the setting up of small and medium firms? The answers to these questions will then affect how regulatory and competition policies are designed to incorporate the special needs of small and medium-sized firms.

Another important revelation is that there is little hypothesis testing particularly in developing countries on the subject matter. For instance, one may hypothesize and test for the assertion that the Impact of regulation on SMEs varies according to firm size and across countries. This is a very important hypothesis which needs further investigating.

Although competition promotes efficiency and reduces wastage in an economy, unhealthy competition can have disastrous effects on economy, especially infant industries. Whereas considerable amount of literature has been generated on regulation, competition and competition policies, very little is known about the impact of regulation o competition. Regulation increases

the transactions costs of firms, which in turn makes them less competitive but there is lack of empirical evidence on the impact of regulation on firms, particularly SMEs.

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Notes

[1] There is no attempt to present a detailed review on regulation and competition since this will be the focus of some researchers at the conference.
[2] Refer to Kay and Vickers (1988) for an extensive discussion on the rationale for regulation.
[3] Defined as `the ability of companies, industries, regions, nations or supra-national regions to generate, while being and remaining exposed to international competition, relatively high factor income and factor employment levels' (OECD, 1996e).
[4] Elaian, K (1996), Employment implications of small-scale industries in developing countries: evidenec from Jordan, Science, Technology and Development, 14(1).
[5] Defined in Holden, Sobotka and Locklin (1998) as the cost of doing business or the cost of using the market. They are not related to factor inputs, goods or services but rather to the cost of using the mechanisms of production and exchange.
[6] A World Bank Survey of firms in 1989 reported that credit was a major or moderate problem for 89% of sampled firms. Also see Aryeetey et al, 1994; Kayanula and Quartey, 2000.
[7] Also refer to Aryeetey, Asante, Kyei and Gockel, 1990:20-21

Micro, small and medium-sized enterprises make up 99% of all businesses in the EU. In 2015, just under 23 million SMEs generated EUR 3.9 trillion in value added and employed 90 million people, constituting an essential source of entrepreneurial spirit and innovation, which are crucial for the competitiveness of EU companies.Â In 2020, a review by the European Court of Auditors[1] found that while the SME instrument provides effective support to SMEs in developing their innovation projects, there were some challenges in delivery, for example in terms of regional coverage and the late introduction of the non-bankability criterion. Regulation, competition and small and medium. Enterprises in developing countries. Peter Quartey University of Manchester. October 2001.Â Nonetheless, the developmental role of the small and medium scale enterprises (SMEs) sector in developing countries has been highly recognised. They serve as engines through which the growth objectives of developing countries can be achieved. It is estimated that SMEs employ 22% of the adult population in developing countries (Daniels, 1994; Daniels & Ngwira, 1992; Daniels & Fisseha, 1992; Fisseha, 1992; Fisseha & McPherson, 1991; Gallagher & Robson, 1995). @inproceedings{Quartey2001RegulationCA, title={Regulation, Competition and Small and Medium Enterprises in Developing Countries}, author={P. Quartey}, year={2001} }. P. Quartey. Published 2001.Â Guidelines for the Analysis of Policies and Programmes for Small and Medium Enterprise Development. Guidelines for the Analysis of Policies and Programmes for Small and Medium Enterprise Development. 1999. Progress, constraints and limitations of financial sector reforms in the least developed countries. Martin Brownbridge Idpm. 1999.